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No. 83-1485

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

JOSEPH A. MOLLER and DOROTHY D. MOLLER,
Petitioners,

v.

THE UNITED STATES,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

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BRIEF OF *AMICUS CURIAE* THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF THE PETITION

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QUESTIONS PRESENTED

1. Whether persons engaged full-time in an activity which produces substantial ordinary income should be denied a deduction for expenses of maintaining an office in the home where the expenses of an office maintained outside the home for the same purposes would be deductible?

2. Whether the requirement of income from short term sales, which would also constitute ordinary income, is a reasonable criterion for the deduction of an office in the home under § 280A where:

(a) the activity engaged in does produce ordinary income; and

(b) non-investor activities which may have no income from sales would be entitled to the deduction?

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This brief is filed by the Washington Legal Foundation, an *amicus curiae*, in support of the petition for certiorari, with the consent of all the parties.

INTERESTS OF *AMICUS CURIAE*

The Washington Legal Foundation (WLF) is a national non-profit public interest law center that engages in litigation and the administrative process in matters affecting the broad public interest. WLF has more than 85,000 members throughout the United States whose interests the Foundation represents.

WLF participates in and has devoted a substantial portion of its resources to cases relating to government regulations and constitutional law involving the rights of citizens and businesses. WLF has appeared in the United States Supreme Court on many occasions as *amicus curiae*. Briefs *amicus curiae* of the Foundation have been filed with and accepted by the United States Supreme Court in cases such as *Consolidated Edison Co. of New York v. Public Service Commission of the State of New York*, 100 S. Ct. 2326 (1980); *United Steel Workers v. Weber*, 443 U.S. 193 (1979); *Carbon Fuel Co. v. United Mine Workers*, 442 U.S. 939 (1979); *Personnel Administrator of Mass. v. Feeney*, 442 U.S. 256 (1979); *Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979); and *Federal Trade Commission v. Standard Oil Co. of California*, 100 S. Ct. 62 (1980).

In the instant case, WLF believes that the public interest is furthered by consistent and reasonable interpretations of our nation's tax laws. However, the lower court's decision in this case does great violence to these principles by construing § 280A of the Internal Revenue Code relating to the deductibility of home office expenses in such a way as to discriminate against citizens such as these Petitioners who have extensively and actively used their home for conducting their trade and business. The lower court's distinction between the derivation of income from the long-term holding of securities as opposed to realizing short-term profits is an artificial and discriminatory one that lacks any rational basis and is contrary to the intent of Congress and the public interest.

STATEMENT OF THE CASE

Congress enacted § 280A of the Internal Revenue Code to "curb widespread abuses" resulting from tax deductions for primarily personal expenses taxpayers incurred by using a part of their homes for occasional work. S. Rept. 94-938 (1976), 1976-3 C.B. (Vol. 3) 89, 147. The

potential for abuse in this area was typified by the situation of a taxpayer making a dubious claim for a home office deduction. S. Rept. 94-938 (1976), 1976-3 C.B. (Vol. 3) 49, 183-185.

Many taxpayers used dens as a home office and allocated a portion of household expenses to business use even though they continued to use the space for personal purposes. While taxpayers had no increase in costs, they frequently prevailed in deducting otherwise nondeductible personal living expenses because of a lack of rules in this area. 10 *Journal of Real Estate Taxation* 1, 63.

In determining the deduction where there was mixed personal and business use, the government followed an allocation formula generally based on space and time. Problems arose regarding the time test and whether a taxpayer had to compare actual use to availability for use or to total use. While the government argued for the former, the Tax Court adopted the latter test. *Id.* at 65. While various allocations were required, the law was still unclear and even where a home office produced little increase in costs, taxpayers nonetheless obtained deductions which often allowed them to take personal expenses as a business deduction. *Id.* at 66.

Section 280A was thus enacted to provide "definitive rules relating to deductions for expenses attributable to the business use of homes." S. Rept. 94-1236 (1976), 1976-3 C.B. (Vol. 3) 807, 839. Section 280A(c)(1)(A), which is the pivotal provision here, allows a deduction for a portion of the home exclusively used on a regular basis "[as] the principal place for any trade or business of the taxpayer."

In the area of investments, Congress saw nothing inappropriate in the deduction of expenses under § 280A. This area, as with other enterprises capable of being conducted in the home, was simply subject to the same concerns which motivated Congress to enact § 280A.

When Senator Long, Chairman of the Senate Finance Committee, introduced § 280A on the floor of the Senate, he stated:

> While in theory there is nothing wrong with appropriate deductions for business or investment expenses, in practice it is often extremely difficult to allocate between deductible business expenses and nondeductible personal expenses. The result is that many people are deducting excessive amounts, and the bill places strict limits on these deductions.

122 Cong. Rec. 18, 542 (1976).

As with other activities, Congress felt casual and occasional activities were inappropriate for a § 280A deduction in the area of investments. The Senate Finance Committee Report states a deduction is not allowed where a taxpayer uses a portion of the home "to read financial periodicals and reports, clip bond coupons and performs similar activities because the activity is not a trade or business." S. Rept. 94-938 (1976), 1976-3 C.B. (Vol. 3) 49, 187.

Significantly, the Report stated a deduction is not allowed such a taxpayer "who is not in the trade or business of making investments," indicating, consistent with Senator Long's statement, that investment expenses are allowed under § 280A under appropriate circumstances. *Id.*

Against this backdrop, the Mollers equipped and set aside two rooms in their home as an office in which they conducted their extensive investment activities. The Mollers each devoted between 40 and 42 hours per week to their investments in their home office, which was specifically set aside for this purpose and no part of which was used for personal purposes. There is agreement that the Mollers required this office for their extensive investment activities. The government twice conceded that the office was necessary for the Mollers' investment work.

The Mollers' full time investment activities yielded substantial ordinary income. Their activities annually produced increased ordinary income on which they paid correspondingly increased federal income tax. The Court below found, however, that the Mollers did not derive their income from short-term sales of securities, and thus did not realize the right kind of income to be engaged in an activity entitled to a § 280A deduction.

The law is clear that if the Mollers had rented an office outside their home, they could have deducted this expense. But because they chose to set aside an office in their home, the expense has been held nondeductible. Ironically, this is not the law with respect to other business activities which also produce ordinary income, even in cases which may produce less income and require less time and effort than in the Mollers' case.

The decision below results in discrimination against an active investor. It has no relation to the purpose of § 280A. If this rationale is applied to non-investor activities, it will deny a home office deduction in cases where it should be and has been plainly allowed.

REASONS FOR GRANTING THE WRIT

I. The Decision Below Impermissibly Discriminates Against Full Time Legitimate Investors Who Use An Office In The Home For Business Purposes Only.

Central to the holding of the Court of Appeals below is that the Mollers did not seek "income from the relatively short-term turnover of stocks" or "'endeavor to catch the swings in the daily market movements and profit thereby on a short term basis.'" 721 F.2d at 813, 814.

If the Mollers had engaged in such transactions they could have realized ordinary income in the form of short term capital gains. Likewise, the substantial income the

Mollers' investment activities did produce was also ordinary income, but rather in the form of dividends and interest. By design, however, gains from the sales of securities were offset by losses.

A person who sells real estate in a sufficient number of transactions, typically far fewer than the Mollers' securities sales, is in a trade or business and realizes ordinary income. *Biedenharn Realty Co., Inc. v. United States*, 526 F.2d 409 (5th Cir. 1976), held a taxpayer's sale of 38 lots in 37 transactions over three years constituted a business and produced ordinary income. 526 F.2d at 416-17. If that activity were conducted in a home office, there is no question a § 280A home office deduction would be allowed.

Similarly, an author may spend a great amount of time compiling, researching and writing a book. Many authors do not publish a work each year. An author who does not sell a book during the taxable year is nonetheless in a trade or business. *Faura v. Commissioner*, 73 T.C. 849 (1980). If such an author maintained a home office in which he kept files and research notes, and performed his writing, expenses allocable to it would be deductible under § 280A.

Likewise, an artist is in a trade or business who spends an entire year building an inventory while making no sales. *de Grazia v. Commissioner*, 21 T.C.M. 1572, Dec. 25, 804 (M), TC Memo. 1962-296. If the artist were to maintain a studio in a separate room in his home, and used it regularly and exclusively as required by § 280A, there is no question this home office would qualify for a deduction.

A self-employed musician who fills in for orchestras and otherwise performs for a fee is in a trade or business. *Elliott v. United States*, 250 F. Supp. 322 (W.D. N.Y. 1965). In *Drucker v. Commissioner*, 715 F.2d 67 (2nd Cir. 1983), the Court held a practice room main-

tained by a musician in his home deductible under § 280A. The practice room was the musician's principal place of business because practice was indispensable to his performance, and his employer provided no place to practice. The musician's practice room therefore qualified for deduction under § 280A(c)(1)(A) as a principal place of business maintained for the convenience of the employer. However, a self-employed musician would be entitled to the same deduction under § 280A(c)(1)(A) if he maintained a practice room.

In *Drucker*, it was significant that because the practice room was required and was used solely for that purpose, the "expense was almost entirely additional to nondeductible personal living expense." 715 F.2d at 70. In the Mollers' case, their office was undeniably required for their investment activities, and was used solely for that purpose. The expense of their office was therefore in addition to nondeductible personal living expenses, and thus the type of expense § 280A intended to be deductible.

If a home office is deductible by all of the above persons, some of whom realize no present profit whatever from their current activities, surely something is seriously deficient in a holding that a full time activity which produces substantial current ordinary income does not qualify for a home office deduction under § 280A.

It is important for this Court to review whether § 280A was ever intended to produce such a discriminatory result. Without this Court's guidance, this area of the law will remain in total disarray.

II. The Lower Court's Requirement of Short Term Profits Results In Discrimination Not Intended By Section 280A.

In *Snow v. Commissioner*, 416 U.S. 500 (1974), this Court overruled a holding of the Sixth Circuit that a

partnership could not deduct research and experimental expenses under § 174 of the Code. The Sixth Circuit had denied the deduction on the grounds that the partnership was not in a trade or business because it had not produced a product for sale during the taxable year. *Snow v. Commissioner*, 482 F.2d 1029, 1031 (6th Cir. 1973).

This Court reversed on the basis that § 174 allowed the deduction of research and experimental expenses "in connection with" the taxpayer's trade or business, and was thus intended by Congress "to equalize tax benefits of the ongoing companies and those that are upcoming and about to reach the market . . . ." 416 U.S. at 504. To deny the deduction would thus "defeat the congressional purpose . . . by perpetuating the discrimination below and urged on us here." *Id.*

The rationale of the Court of Appeals' decision in the present case would foster the identical discrimination. The basis of the Court's holding is that the Mollers did not seek profits through short-term sales or swings in the market. A business like the partnership in *Snow* which had no sales, and therefore no income, should fare no better than the Mollers. The discrimination that could not be practiced against the partnership under § 174 should not be practiced against it under § 280A. However, under the decision of the Court below, the *Snow* partnership would be denied a § 280A deduction if it operated in a home office because it would be deemed not to be in a trade or business.

Section 280A reflects the longstanding congressional policy of allowing the deduction of legitimate business expenses in arriving at taxable income. Under § 280A, those who conduct their business in their homes are allowed the same deduction permitted those who conduct their business outside the home.

The Mollers could plainly deduct the cost of an office they had rented outside the home because it is a legiti-

mate business expense. However, the additional requirement of short term profits in the decision below denies them a deduction for an office maintained in the home for the same purpose.

The effect of the decision below extends beyond the case of investors. Under *de Grazia* and *Faura*, *supra*, it is clear that taxpayers can be in a trade or business although they make no current sales. In the case of an author, he might rely on royalties from books sold in past years while preparing a book during the current year for sale in the next. Under the rationale of the decision below, the author would be denied a § 280A deduction for his office because his current efforts produced no income from current sales.

The same rationale would apply to deny the deduction of a self-employed musician who maintained a practice room under the rule announced in *Drucker*, *supra*. The activity in the home office would produce no income whatever and would therefore be denied trade or business status under the decision below.

Such persons are plainly entitled to a deduction for a home office used and maintained as required by § 280A, however. Accordingly, a decision which would deny them a deduction requires review by this Court.

CONCLUSION

For all of the reasons set forth above and for the additional reasons advanced in the petition in this case, the writ of certiorari should be granted.

Respectfully submitted,

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